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EX PARTE

July 24, 1998

Ms. Magalie Roman Salas
Secretary - Federal Communications Commission
1919 M Street, N.W. Room 222
Washington, D.C. 20554

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RE: CC Docket No. 96-45

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Dear Ms. Salas,

On July 23, 1998, the attached letter and accompanying attachments were sent to the Honorable Julia Johnson, Chairman of the Florida PSC and State Chair of the Federal-State Joint Board with respect to the above referenced docket. The information was provided in response to issues raised during the course of a July 17, 1998 meeting with Ms. Johnson and members of the Florida PSC staff (see Sprint's ex parte notice dated July 20, 1998).

The original and one copy of this notice are being submitted to the Secretary of the FCC in accordance with Section 1.1206(b)(1) of the Commission's rules. If there are any questions, please call.

Sincerely,

Pete Sywenki

Attachments

No. of Copies rec'd
List ABCDE

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July 23, 1998

Julia Johnson, Chairman
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850

Dear Chairman Johnson,

Thanks for meeting with us last Friday. We appreciate you taking time out of your busy schedule to discuss Universal Service and related issues. We have enclosed two documents for you to review, a short summary of Sprint's USF recommendations and a response to GTE's Uniform Pricing Proposal. Please feel free to contact Jim Sichter (913) 624-1303, Sue McCanless (913) 534-3131 or me if you have any questions, suggestions or comments.

Sprint looks forward to continuing dialogue with you on these issues.

Sincerely,

Emeric Kapka

EK:len
Enclosures

cc: Mark Long
Greg Fogleman
Jim Sichter
Sue McCanless
Monica Barone

SPRINT'S PROPOSAL TO TIE USF SUPPORT TO LOCAL RATE LEVELS

Sprint is a strong supporter of a national Universal Service Fund (USF) based on total (state and interstate) end user revenues. Basing USF on total revenues not only provides the broadest basis of support, minimizing the burden of USF on any particular service or customer, but is also essential to achieve the goal of competitive neutrality.

However, Sprint recognizes the concerns of states that are potential net contributors to a national USF that customers in their state would be forced to flow subsidies to states where local rates are already inordinately low, and in fact often lower than the local rates in the contributor states.

Sprint shares this concern. The Telecom Act requires the elimination of implicit subsidies. There are only two alternatives to achieving this goal: rate rebalancing or the replacement of implicit subsidies embedded in current rate structures, especially access, with an explicit and competitively neutral universal service fund. Relying exclusively on either alternative is not a viable policy. Cost based local rates in very high cost areas could jeopardize universal service. But maintaining local rates at the existing levels is not necessary to preserve universal service, and would result in an unacceptably high and burdensome USF. For those reasons, Sprint supports an approach that combines both USF support for high cost areas and local rate rebalancing.

In this context, we would propose that the availability of USF support from a national USF fund be tied to minimum local rate levels. One means of accomplishing this would be to reduce the USF support available to a company in

proportion to the degree to which that company's local rates were below some minimum local rate level. Sprint would advocate that that minimum local rate level be set at the national average local service rate (including interstate SLC) of approximately \$20. Clearly, local rates at this level have proven to be "affordable" and would not jeopardize universal service. Those states with inordinately low local service rates should be "encouraged" to raise local rates to the national average local service rate level, rather than leaving implicit subsidies in access. This increase will begin to address not only the requirements of the Telecom Act, but also accountability concerns of contributor states. Any increase in current local service rates to the national average level would be offset, dollar for dollar, with reductions in access rates (including imputation to intraLATA toll).

To illustrate how this plan would work, assume two companies with areas (e.g., a wire center) that have the same cost characteristics but different local rates. Under existing USF proposals, both companies would receive the same level of USF support.

	Company 1	Company 2
Average cost per access line	\$65	\$65
USF support @\$40 benchmark	\$25	\$25
Average local residential rate	\$10	\$20

The result would be that Company 1 would still have high implicit subsidies (particularly high access subsidies) relative to similarly situated Company 2. Clearly, local rates in Company 1 could be increased without jeopardizing universal service. Conversely, the high access subsidies maintained by Company 1 are a burden to customers of other companies (since those access subsidies are built into averaged IXC toll rates).

One way to provide incentives for a state to rectify such a situation is to withhold some amount of USF support to companies with inordinately low local service rates. One alternative would be as follows:

1. The national USF fund will support all costs above a national benchmark (\$40 in this example).
2. A minimum local service rate level standard would be set. As noted above, Sprint would propose that this be set at \$20. Rather than using the local service rate only, it might be appropriate to use the sum of the local rate and the explicit intrastate USF support for that area. That is, if a state determines that the \$20 local rate level would jeopardize universal service, it would have the option of adopting a state USF, assessed and collected on intrastate revenues only, to make up the difference between the actual local rate and the \$20 local rate standard.
3. If a company doesn't meet the conditions of #2 above, its national USF support would be reduced as follows:
 - a. National USF support per access line
 - b. Less: the difference between the actual local rate (or local rate plus explicit state USF support) and the \$20 local rate standard.

In the context of the above example, the national USF support for Company 2 would be unaffected. Company 1 in the example, however, would have its national USF reduced by difference between its \$10 local rate and the \$20 local rate standard. As a result, it would receive USF support of \$15 per access line rather than the \$25 it would qualify for if its local rates were at \$20.

State commissions and local exchange carriers may need to review existing price cap regulation plans which became effective prior to the implementation of the Telecom Act. Modifications such as increases in local service rates to a national average, with corresponding decreases in access, should be made to the price cap plan in a timely and streamlined manner. In addition, it may be appropriate to allow states a short transition period during which they could increase local service rates to the minimum level or adopt a state USF to make up the difference between the existing local service rate and the minimum local rate.

REVIEW OF GTE'S UNIFORM PRICING PROPOSAL

We have completed our review of the GTE "Uniform Pricing" proposal. While we certainly appreciate GTE's effort to craft a solution, Sprint believes GTE's proposal is flawed on both theoretical and practical grounds. We outline these concerns below.

Sprint remains convinced that access flow through is a "perception" issue. Actual long distance prices have decreased in excess of access reductions in the past and will continue to do so in the future. The fact that long distance rates for all services have not been reduced proportionately has given rise to erroneous allegations that access charge reductions have not been flowed through. However, implementation of a uniform pricing proposal would tend to harm the working of the competitive process to the detriment of consumers and providers.

Most industry observers we talk with envision a new Universal Service Fund (USF) based on a general framework designed to achieve two goals: minimize total consumer payments for universal service so that consumers are actually paying for universal service and not for something else and collect universal service payments in a non-intrusive (and explicit), but competitively neutral way. ILECs would price access services at TELRIC- based rate levels and model the difference between underlying loop costs and appropriate local service revenues to determine the amount of universal service funding. Sprint, like many others, believes that universal service should be funded explicitly through a surcharge on customer bills. Sprint and GTE agree that the FCC is required to establish an explicit, competitively neutral support mechanism for universal service and in doing so must eliminate today's system of implicit support. This change may cause changes to individual consumer bills based on usage levels. Those with low

volumes may see an increase while those with relatively higher volumes may see a decrease.

GTE attempts to address this concern through its proposal by creating an incentive plan under which IXCs would voluntarily pass through access reductions in a uniform way. As we understand the GTE proposal, there would essentially be two interstate access tariffs in place, Schedule A and Schedule B. IXCs would be able to order access out of Schedule A for a particular ILEC only if the IXC applied the reductions uniformly across-the-board to all customers. That reduction would have to be separately listed on the bill and not included in the rates of the IXC. IXCs that would not agree to these conditions could only order access out of Schedule B. Presumably all IXCs (500+ of them?) would agree to this proposal in order to receive from all ILECs (CLECs?) the access reductions made possible through USF changes.

At first glance, this may appear to be a straightforward approach. The problem though is that uniform pricing creates its own set of problems, further exacerbating the harm caused by the existence of untargeted subsidies. Sprint suggests a different approach, but first we outline the reasons why a uniform pricing proposal will not work.

Apart from any legal discriminatory challenges such a tariff would likely bring, there are two basic problems with the uniform credit mechanism.

First, there **is** a direct connection between an individual consumer's purchase of long distance service and the associated access configuration or access cost of providing service. Said differently, the access cost of providing service to individual consumers is non-uniform; any access cost decrease will affect consumers differently based on the services they buy.

Second, access costs are just one of the factors in the IXC's overall pricing calculus. The uniform pricing proposal would not only interfere with the relationship between customer prices and customer costs regarding access, but it would also interfere with the normal, non-access cost driven market pricing strategies in which all IXCs, in fact, all competitive firms, engage. We attempt to explain each of these in more detail below.

To understand the first concern, assume two different consumers, the first makes 100 minutes of domestic interstate MTS calling and the second makes 100 minutes of international calling in a month. Assume that MTS is priced by IXC A at 20 cents/minute while international is priced at 50 cents/minute. Assume these relative prices reflect competitive market conditions. Consumer A would thus pay \$20.00 for long distance calling (\$.20 times 100 minutes) while consumer B pays \$50.00 for long distance calling (\$.50 times 100 minutes). On average, consumer A is paying \$.20/minute while consumer B is paying \$.50/minute.

Assume that interstate access costs for IXC A total \$.10/billed minute, \$.05/billed minute on both the originating and terminating end of a call. IXC A uses interstate access on both ends of consumer A's domestic MTS minutes but uses only interstate access on the originating side of consumer B's international calls. This situation is depicted in the table labeled "Current Situation."

CURRENT SITUATION

"CONSUMER A"	Usage (Minutes)	Consumer/ Expenditure	Interstate Access Cost
Domestic MTS (@\$.20/Minute)	100	\$20.00	\$10.00
International (@\$.50/minute)	0	0	0
TOTAL	100	\$20.00	\$10.00

"CONSUMER B"	Usage (Minutes)	Consumer/ Expenditure	Interstate Access Cost
Domestic MTS (@\$.20/Minute)	0	\$0.00	\$0.00
International (@\$.50/minute)	100	\$50.00	\$5.00
TOTAL	100	\$50.00	\$5.00

Assume that as part of USF changes, all ILECs reduce access prices by 50% to \$.025/billed minute. Under a uniform price reduction, IXC A would have to credit both consumer A and consumer B "uniformly," – presumably by the average access reduction. This situation is depicted in the table labeled "Implementation of Uniform Pricing." But note that consumer A's access configuration includes interstate switched access at both ends while consumer B's international usage includes switched access at only the originating end of the call(s). After the access reduction, the underlying interstate access cost **saving** of providing service to consumer A is \$.05/minute while the interstate access cost **saving** of providing service to consumer B is \$.025/minute. Cost based pricing would tend to make the domestic MTS price decline by \$.05 from

\$.20 to \$.15 while the price of an international minute would only decline by \$.025 from \$.50 to \$.475. Any deviation from this result would be sub-optimal. How would the uniform reduction proposed by GTE occur? Each of IXC A's customer bills would be reduced uniformly by the credit percentage on a uniform basis. IXC A's access cost per billed minute is a function of many factors, including mix of product, mix of customer type, choice of access configuration (switched access vs. special access) use of ILEC facilities vs. CLEC facilities, among other factors. We can assume in this example that the percentage for IXC A is 20%. In other words, IXC A's cost of access as a percentage of billed revenue declines by 20% meaning that each customer would receive a credit equal to 20% of billed revenue on a uniform basis.

IMPLEMENTATION OF UNIFORM PRICING AND USF

"CONSUMER A"	Usage (Minutes)	Consumer/ Expenditure	Interstate Access Cost
Domestic MTS (@\$.20/Minute)	100	\$20.00	\$5.00
International (@\$.50/minute)	0	0	0
TOTAL	100	\$20.00	\$5.00
Less: Uniform Flow Through (@ 20%)	0	\$4.00	0
Net Consumer Expenditure	0	\$16.00	0

"CONSUMER B"	Usage (Minutes)	Consumer/ Expenditure	Interstate Access Cost
Domestic MTS (@\$.20/Minute)	0	\$0.00	\$0.00
International (@\$.50/minute)	100	\$50.00	\$2.50
TOTAL	100	\$50.00	\$2.50
Less: Uniform Flow	0	\$10.00	0

Through (@ 20%)			
Net Consumer Expenditure	0	\$40.00	0

Thus, consumer A would receive a credit of \$4.00 (20% of \$20.00) lowering the after discount price of service to \$.16/minute. Consumer B would also receive a 20% credit, lowering the bill to \$40.00 or \$.40/minute. This situation is shown in the table labeled "Impact" below. Contrast this to the competitive solution which would result in prices for consumer A of \$.15/minute and for consumer B in prices of \$.475/minute, reflecting a \$.025/minute cost decrease on each end of a call. In effect, the uniform price reduction would lower the price of service for consumer A by 4 cents per minute and for consumer B by 10 cents per minute. The domestic user subsidizes the international user. Hardly a uniform price reduction. Are there any ways around this problem? As long as the uniform credit appears on the bill, there will be some users "subsidizing" other users. And this subsidy will not be based on any policy goals of the FCC or anyone else, but rather, the subsidy will be based on individual customer usage patterns.

IMPACT OF UNIFORM PRICING AND USF

	Consumer A	Consumer B
Consumer Savings	\$4.00	\$10.00
Consumer Savings/Minute	\$0.04	\$0.10
Interstate Access Cost Change	\$5.00	\$2.50
Interstate Access Cost Change/Minute	\$0.05	\$0.025

The second basic problem with the GTE approach is that it does not lend itself to the real world competitive marketplace.

Access costs are just one of many IXC costs that determine an IXC's prices and pricing strategy. Access costs are the largest single cost component and therefore are important. Because of the lack of widespread alternatives to ILEC access, especially for switched access, access costs continue to be priced at several multiples of TELRIC and therefore IXCs are engaged in efforts to attempt to find suitable alternatives to ILEC provided access. But consider that other factors play into an IXC's pricing strategy. At Sprint, for example, we run many pricing promotions around our affiliation with the National Football League, including Monday night special pricing and Prepaid FonCard (calling card) promotions. These pricing/promotions are scheduled around the NFL season, not around access charge changes. Access charge changes operate on a different schedule than the NFL does. Clearly, a uniform pricing proposal would cause havoc and interfere with our marketing plans for the NFL tie-in. Or consider that customer churn is a large non-access cost factor that drives customer costs. IXCs, and other firms operating in competitive markets, attempt to control this important cost in various ways, including pricing differences that reflect a customer's "loyalty." GTE's proposal would interfere with loyalty pricing by forcing IXCs to reduce prices proportionally for higher costing, higher churn customers as compared to lower costing, lower churn customers. This is not only potentially sub-optimal but more importantly, harms low-cost (low churn) customers.

IXCs have spent millions of dollars differentiating themselves from each other through marketing plans which include price differentials – MCI's "5 cent Sundays," AOL's "flat 9 cent calling plan" and Sprint's "Sprint Sense Anytime" come to mind. GTE's plan would tend to reduce the competitive ability of IXCs to respond to each other, and to the consuming public. IXCs would be forced to reduce rates for services that are not promoted or that already have very low margins. Further, the GTE proposal would require the reduction to be separately listed on the bill and not included in IXC rates. To the customer this would look like a tax rebate as opposed to lower IXC rates. It is

odd that when IXCs were suffering through access overcharging in the past GTE never asked that access be separately listed on the bill and attributed as funds going to the local telephone company. Now that rates are being lowered, GTE would like the local telephone company to be perceived as the entity responsible for the decrease.

It is somewhat ironic that the GTE solution envisions that monopoly ILECs operating under the interstate price cap regime would have more pricing flexibility than IXCs operating in a competitive marketplace. Aside from the irony, uniform pricing proposals are bad public policy for the reasons outlined above. Uniform pricing plans interfere with market-based pricing of several hundred firms engaged in vigorous competition. They would result in unintended subsidy flows that are not based on any recognized public policy objectives.

Given the misconception that consumers are not receiving the benefit of access reductions, how should regulation deal with access flow through? Sprint respectfully suggests that any IXC with more than 5% interstate marketshare would agree to meet with the FCC staff and discuss how it was "flowing through" access reductions in prices on a semi-annual basis. Individual IXCs would share proprietary data in these meetings therefore the meetings would be subject to appropriate confidentiality treatment. In the meetings the IXCs would:

1. Determine the average revenue per minute for domestic (minute driven) service.
2. Determine the average cost of ILEC provided access on a minute driven basis.
3. Determine the average reduction in the price of ILEC provided access on a minute driven basis.
4. After the access reduction, compare the six-month average revenue per minute for domestic (minute driven) service to the previous six-month average revenue.

5. Compare the change in 4 with the change in 3. If 4 is greater than 3, conclude that flow through occurs.

This proposal is simple and straightforward and can be used to show how IXC prices decline in response to access reductions, resulting in increased consumer welfare.